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DEPARTMENT OF AGRICULTURE

Rural Housing Service

7 CFR Part 3555

RIN 0575-AD00

Single Family Housing Guaranteed Loan Program

AGENCY: Rural Housing Service, USDA.

ACTION: Final rule.

SUMMARY: The Rural Housing Service (RHS or Agency) is amending the current regulation for the Single Family Housing Guaranteed Loan Program (SFHGLP) on the subjects of lender indemnification, refinancing, and qualified mortgage requirements. The Agency is expanding its lender indemnification authority for loss claims in the case of fraud, misrepresentation, or noncompliance with applicable loan origination requirements. This action is taken to continue the Agency's efforts to improve and expand the risk management of the SFHGLP. The Agency is amending its refinancing provisions to simply require that the new interest rate not exceed the interest rate on the original loan and to add a new refinance option, "streamlined-assist." Finally, the agency is amending its regulation to indicate that a loan guaranteed by RHS is a Qualified Mortgage if it meets certain requirements set forth by the Consumer Protection Finance Bureau (CFPB).

DATES: Effective [INSERT DATE 30 DAYS FROM DATE OF PUBLICATION IN THE FEDERAL REGISTER.]

FOR FURTHER INFORMATION CONTACT: Lilian Lipton, Finance and Loan Analyst, Single Family Housing Guaranteed Loan Division, STOP 0784, Room 2250, USDA Rural Development, South Agriculture Building, 1400 Independence Avenue SW., Washington, DC 20250-0784, telephone: (202) 260-8012, email is lilian.lipton@wdc.usda.gov

SUPPLEMENTARY INFORMATION:

Classification

This final rule has been determined to be non-significant by the Office of Management and Budget (OMB) under Executive Order 12866.

Executive Order 12988, Civil Justice Reform

This rule has been reviewed under Executive Order 12988, Civil Justice Reform. Except where specified, all State and local laws and regulations that are in direct conflict with this rule will be preempted. Federal funds carry Federal requirements. No person is required to apply for funding under this program, but if they do apply and are selected for funding, they must comply with the requirements applicable to the Federal program funds. This rule is not retroactive. It will not affect agreements entered into prior to the effective date of the rule. Before any judicial action may be brought regarding the provisions of this rule, the administrative appeal provisions of 7 CFR part 11 must be exhausted.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), Public Law 104-4, establishes requirements for Federal agencies to assess the effect of their regulatory actions on State, local, and tribal governments and the private sector. Under section 202 of the UMRA, the Agency generally must prepare a written statement, including a cost-benefit analysis, for proposed and final rules with "Federal mandates" that may result in expenditures to State, local, or tribal governments, in the aggregate, or to the private sector, of \$100 million, or more, in any one year. When such a statement is needed for a rule, section 205 of the UMRA generally requires the Agency to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, most cost-effective, or least burdensome alternative that achieves the objectives of the rule. This final rule contains no Federal mandates (under the regulatory provisions of Title II of the UMRA) for State, local, and tribal governments or the private sector. Therefore, this rule is not subject to the requirements of sections 202 and 205 of the UMRA.

Environmental Impact Statement

This document has been reviewed in accordance with 7 CFR Part 1940, subpart G, "Environmental Program." It is the determination of the Agency that this action does not constitute a major Federal action significantly affecting the quality of the human environment, and, in accordance with the National Environmental Policy Act of 1969, Pub. L. 91-190, neither an Environmental Assessment nor an Environmental Impact Statement is required.

Executive Order 13132, Federalism

The policies contained in this rule do not have any substantial direct effect on States, on the relationship between the national government and States, or on the distribution of power and responsibilities among the various levels of government. Nor does this rule impose substantial direct compliance costs on State and local governments. Therefore, consultation with the States is not required.

Regulatory Flexibility Act

In compliance with the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) the undersigned has determined and certified by signature of this document that this rule change will not have a significant impact on a substantial number of small entities. This rule does not impose any significant new requirements on Agency applicants and borrowers, and the regulatory changes affect only Agency determination of program benefits for guarantees of loans made to individuals.

Executive Order 13175, Consultation and Coordination with Indian Tribal Governments

This executive order imposes requirements on RD in the development of regulatory policies that have Tribal implications or preempt tribal laws. RD has determined that the final rule does not have a substantial direct effect on one or more Indian Tribe(s) or on either the relationship or the distribution of powers and responsibilities between the Federal Government and Indian Tribes. Thus, this rule is not subject to the requirements of Executive Order 13175. If a Tribe determines that this rule has implications of which RD is not aware and would like to engage with RD on this rule,

please contact RD's Native American Coordinator at (720) 544-2911 or
AIAN@wdc.usda.gov.

Executive Order 12372, Intergovernmental Consultation

This program/activity is not subject to the provisions of Executive Order 12372, which require intergovernmental consultation with State and local officials. (See the Notice related to 7 CFR part 3015, subpart V, at 48 FR 29112, June 24, 1983; 49 FR 22675, May 31, 1984; 50 FR 14088, April 10, 1985).

Programs Affected

This program is listed in the Catalog of Federal Domestic Assistance under Number 10.410, Very Low to Moderate Income Housing Loans (Section 502 Rural Housing Loans).

Paperwork Reduction Act

The information collection and record keeping requirements contained in this regulation have been approved by OMB in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*). The assigned OMB control number is 0575-0179.

E-Government Act Compliance

The Rural Housing Service is committed to complying with the E-Government Act, to promote the use of the Internet and other information technologies to provide

increased opportunities for citizen access to Government information and services, and for other purposes.

Non-Discrimination Policy

The U.S. Department of Agriculture (USDA) prohibits discrimination against its customers, employees, and applicants for employment on the bases of race, color, national origin, age, disability, sex, gender identity, religion, reprisal, and where applicable, political beliefs, marital status, familial or parental status, sexual orientation, or all or part of an individual's income is derived from any public assistance program, or protected genetic information in employment or in any program or activity conducted or funded by the Department. (Not all prohibited bases will apply to all programs and/or employment activities.)

If you wish to file a Civil Rights program complaint of discrimination, complete the [USDA Program Discrimination Complaint Form](#) (PDF), found online at http://www.ascr.usda.gov/complaint_filing_cust.html, or at any USDA office, or call (866) 632-9992 to request the form. You may also write a letter containing all of the information requested in the form. Send your completed complaint form or letter to us by mail at U.S. Department of Agriculture, Director, Office of Adjudication, 1400 Independence Avenue, S.W., Washington, D.C. 20250-9410, by fax (202) 690-7442 or email at program.intake@usda.gov.

Individuals who are deaf, hard of hearing or have speech disabilities and you wish to file either an EEO or program complaint please contact USDA through the Federal Relay Service at (800) 877-8339 or (800) 845-6136 (in Spanish).

Persons with disabilities, who wish to file a program complaint, please see information above on how to contact us by mail directly or by email. If you require alternative means of communication for program information (e.g., Braille, large print, audiotape, etc.) please contact USDA's TARGET Center at (202) 720-2600 (voice and TDD).

Background Information

On March 5, 2015, RHS published a proposed rule with request for comments for the Single Family Housing Guaranteed Loan Program (SFHGLP) (80 FR 11950-11954). Rural Development received comments from seventeen respondents. Comments were from lenders, secondary market sources, builders, and other interest groups. Specific public comments and substantive changes from the proposed rule are addressed below in general order of appearance in the regulation, not based in the order of importance.

One respondent requested the Agency to clarify when the rule would become effective and what the trigger events will be for the effective date of the various requirements for loan applications received by lenders on or after the effective date of the final rule. The final rule will become effective 60 days after its publication in the Federal Register.

Refinancing (§3555.101(d))

Five respondents fully supported the Agency's proposal to amend its refinancing provisions and add the Streamlined-Assist Refinance option.

One respondent supported the Streamlined-Assist Refinance program but requested that the Agency: 1) add repayment requirements for remaining borrowers; 2) limit costs to principal and current interest charges due, reasonable and customary re-conveyance fee, and the upfront guarantee fee; and 3) limit refinance balance to original purchase loan amount. The Agency believes the Streamlined-Assist Refinance's purpose is to increase affordability for current borrowers and implementing the suggested changes will defeat the purpose of this option. No change is made in this provision.

One respondent supported the addition of the Streamlined-Assist Refinance option but requested clarification with regards to the inclusion of the guarantee fee and eligible closing costs. Eligible loan purposes, including fees and closing costs, will remain the same as described on §3555.101(d) for all refinancing transactions. Closing costs may be included in the refinance loan amount. No change is made in this provision.

One respondent requested the eligibility of non-section 502 loans to be refinanced through the program, such as balloon or ARM mortgage products, if they meet USDA eligibility requirements. The Agency does not have statutory authority as this request does not conform with the Housing Act of 1949 limits on refinancing in this program. No change is made in this provision.

Indemnification (§3555.108(d))

Two respondents believe a five-year indemnification period is too long and requested the Agency to maintain the current lender indemnification period of 24 months. The Agency will continue to pursue a five-year indemnification period, similar to those of other federal agencies and as recommended by the Office of Inspector General (OIG)

Report 04703-003-HY. The rule has been amended to clarify that the loan originator will be required to indemnify the Agency and not a subsequent holder or acquirer of the loan. No other change is made in this provision.

Two respondents requested the Agency to amend its definition of default accounts from 30 days delinquent to 60 days. The Agency will maintain the 30-day definition, consistent with other federal agencies. No change is made in this provision.

One respondent encouraged the Agency to add a standard of materiality for the underwriting defect and to specify that there must be a connection between the defect and the cause of default by adding that “The Agency may seek indemnification if fraud or misrepresentation occurs in connection with the origination *and the lender knew, or should have known about the occurrence.*” It also recommended the Agency to clarify that an indemnification does not affect the guaranty status of the loan. RHS will include the standard of materiality and a provision that the loan note guarantee of the holder will not be affected by indemnification by the originating lender.

Qualified Mortgage (§3555.109)

Six respondents requested RHS to update program guidance to incorporate different points and fee limitations than those proposed. The Agency will remain consistent with the Consumer Financial Protection Bureau (CFPB) and other federal agencies in its points and fees limitations. No change is made in this provision.

Two respondents requested the Agency to not adopt CFPB’s 43-percent debt-to-income limit. The Agency had not included any debt-to-income limitation in the proposed rule. The CFPB debt ratio limitations do not apply to loans guaranteed by the

Agency. Until January 20, 2021 or the date on which an agency rule defining qualified mortgages becomes effective (whichever is earlier), loans guaranteed by RHS are presumed to be qualified mortgages under 12 CFR 1026.43(e)(4).

Four respondents noted that Housing Finance Agencies (HFA) loans are exempt from the Qualified Mortgage requirements and are automatically classified as Qualified Mortgages eligible for insurance through the SFHGLP. The Agency is amending its rule and will include language exempting HFAs from the Qualified Mortgage requirements.

Principal Reduction (§3555.304(d))

One respondent wrote that the Mortgage Recovery Advance (MRA) already provides for principal reductions, and that by separating principal reduction from the MRA would complicate the process because loan servicers would now have to take two steps instead of only one. The respondent pointed out that if the PRA is eventually forgiven, it would become a tax liability to borrowers because the Internal Revenue Service (IRS) considers forgiven debt to be taxable income. Struggling low or moderate income borrowers may not be able to handle the additional tax bill. The respondent also indicated that since the PRA results in an unsecured loan which would not be forgiven if the borrower re-defaulted on their mortgage, mortgage loan servicers would be in a position of collecting on an unsecured loan. Mortgage loan servicers do not want to collect unsecured loans, and the respondent suggested that the agency should collect the unsecured loans.

One respondent indicated that the use of separate notes, one for an MRA and one for a PRA, would complicate special loan servicing workouts and may confuse or

overwhelm eligible borrowers. The respondent indicated that the Agency should consider keeping both the MRA and PRA amounts as secured loans to avoid the likelihood of borrower confusion. The respondent also questioned how the PRA would be impacted should the borrower attempt to pay off the loan before the three year period prior to eligibility for debt forgiveness. Should the PRA be forgiven, the respondent suggested that the Agency should report the forgiveness amount to the IRS, and not the servicer. The respondent wrote that should the PRA not be forgiven, attempts to collect the unsecured loan would be detrimental to borrowers recovering from financial difficulties. Attempts to collect unsecured PRAs, suggested the respondent, could ultimately be more costly to the Agency than simply forgiving the amounts advanced. Finally, the respondent questioned whether the MRA and PRA claims should be filed separately or whether both amounts may be submitted in the same claim. Separate filings would be especially complicated according to the respondent.

Two respondents requested the Agency to eliminate the January 1, 2001 to January 1, 2010 timeframe restriction on PRAs.

One respondent supported the Principal Reduction Advance (PRA) proposal but requested that lenders have at least six months to implement the policy in order to allow for internal system integrations related to this process.

After careful review and consideration, the Agency agrees with all the comments submitted, and has decided to not implement the PRA transaction as it had been proposed. The original MRA procedure will remain unaltered and the PRA will not become a separate transaction.

Indemnification: In the Office of Inspector General (OIG) Report 04703-003-HY, SFH GL Loss Claims, the Agency was requested to re-evaluate the timeframe in which the Government can seek indemnification for noncompliance with regulations in loan origination. Present language in 7 CFR 3555.108(d)(1) limits the indemnification to losses if the payment under the guarantee was made within 24 months of loan closing. Origination defects which depart from Agency requirements, however, may cause defaults beyond 24 months from loan closing. Similarly, claims arising from defective originations may occur several years after loan closing. The change will trigger indemnification if the default occurs within five years from origination and the Agency concludes the default arose because the originator did not underwrite the loan according to Agency standards and guidelines, regardless of when the claim is paid. This is similar to how HUD and other federal agencies operate.

The Agency may also seek indemnification if the Agency determines that fraud or misrepresentation occurred in connection with the origination of the loan, regardless of when the loan closed. 7 CFR 3555.108(d)(2). This provision is being clarified to state that the Agency may seek indemnification in cases of fraud or misrepresentation regardless of when the loan closed or when the default occurred.

In addition, the definition of “default” has been added to section 3555.10 to clarify that default is when an account is more than 30 days overdue. This is consistent with how the term is used in the mortgage industry.

Refinance: There are currently two refinance options available to Section 502 borrowers, and the Agency is adding a third option which has been successfully tested in a pilot. The Agency is amending section 3555.101(d)(3)(i) to remove the requirement

that the interest rate of a refinanced loan be at least 100 basis points below the original rate, and instead to require that the new interest rate not exceed the original interest loan's interest rate. The interest rate reduction requirement has proven problematic in rising rate environments. For example, in the case of divorce, the borrower may not be able to refinance as required by their divorce decree or judgment because they cannot secure an interest rate at least 1 percent lower than the first one.

The definition of "streamlined-assist refinance" is being added to 7 CFR 3555.10. On February 1, 2012 RHS created a refinancing pilot known as the "Rural Refinance Pilot." The streamlined-assist refinance differs from the traditional refinance options in that there is no appraisal or credit report requirement in most instances, as long as the borrower has been current on their first mortgage for the previous 12 months and their new interest rate is at least 1 percent lower than their first one. A new appraisal is required for direct loan borrowers who received a subsidy for the purposes of calculating subsidy recapture.

The pilot was designed to assist existing Section 502 direct or guaranteed loan borrowers in refinancing their homes with greater ease in thirty-five eligible states where steep home price declines, unemployment and persistent poverty rates made refinancing a current mortgage into more affordable terms difficult or impossible. Due to the success of the pilot program, RHS will adopt the pilot policy as a refinance option for existing Section 502 direct or guaranteed loan borrowers nationwide in addition to the two traditional refinance loan options of streamlined and non-streamlined. The special refinance loan option will be called "streamlined-assist."

This rule amends 7 CFR 3555.101(d)(3)(vi) to include “streamlined-assist” as one of three available refinance loan options in addition to the traditional “streamlined” and “non-streamlined” refinance loans. Section 3555.101(d)(3)(vi) discusses eligibility requirements for each streamlined and non-streamlined refinance loan. The streamlined-assist refinance will have the same features as the Rural Refinance Pilot described above. Additional eligibility criteria for refinance loans is discussed in Section 3555.101(d)(3).

Qualified Mortgage: The agency is changing Section 3555.109, to indicate that a loan guaranteed by RHS meeting certain CFPB requirements is a “Qualified Mortgage.”

The CFPB published a “Qualified Mortgage” rule (12 CFR part 1026) which became effective January 10, 2014 and implemented in part the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (P.L. 111-203). This rule requires creditors to make a reasonable, good faith determination of a consumer’s repayment ability for any consumer credit transaction secured by a dwelling, and establishes a safe harbor from liability for transactions that meet the requirements for “qualified mortgages.” Currently, SFHGLP loans are considered to be qualified mortgages if they meet the requirements in 12 CFR 1026.43(e)(2)(i)-(iii) and the points and fees limits in 12 CFR 1026.43(e)(3) until RHS promulgates its own rules regarding qualified mortgages, or January 10, 2021, whichever is earlier. (See 12 CFR 1026.43(e)(4)).

RHS guaranteed loans currently meet these requirements. Therefore, section 3555.109 is clarifying that RHS guaranteed loans which meet the CFPB requirements in 12 CFR 1026.43(e)(2)(i)-(iii) and 12 CFR 1026.43(e)(3) are considered qualified mortgages.

List of Subjects in 7 CFR Part 3555

Home improvement, Loan programs – Housing and community development, Mortgage insurance, Mortgages, Rural areas.

For the reason stated in the preamble, Chapter XVIII, Title 7 of the Code of Federal Regulations is amended as follows:

PART 3555 – GUARANTEED RURAL HOUSING PROGRAM

1. The authority citation for Part 3555 continues to read as follows:

Authority: 5 U.S.C. 301, 42 U.S.C. 1471, et seq.

2. Amend § 3555.10 by adding definitions of Default and Streamlined-assist refinance in alphabetical order to read as follows:

§ 3555.10 Definitions and abbreviations.

* * * * *

Default. A loan is considered in default when a payment has not been paid after 30 days from the date it was due.

* * * * *

Streamlined-assist refinance. A streamlined-assist refinance is an abbreviated method of refinancing which does not require a credit report, or the calculation of loan-to-value or

debt-to-income ratios. Lenders must verify that the borrower has been current on their existing loan for the preceding 12 month period.

* * * * *

3. Section 3555.101 is amended by revising paragraphs (d)(3)(i), (ii), and (iv) to read as follows:

§ 3555.101 Loan purposes.

* * * * *

(d) * * *

(3) * * *

(i) Three options for refinancing may be offered: streamlined, non-streamlined, and streamlined-assist. Other than provided in this paragraph, no cash out is permitted for any refinance. Documentation costs and underwriting requirements of subparts D, E, and F of this part apply to streamlined and non-streamlined refinances.

(A) Lenders may offer a streamlined refinance for existing Section 502 Guaranteed loans, which does not require a new appraisal. The lender will pay off the balance of the existing Section 502 Guaranteed loan.

(B) Lenders may offer non-streamlined refinancing for existing Section 502 Guaranteed or Direct loans, which requires a new and current market value appraisal. The amount of the new loan must be supported by sufficient equity in the property as determined by an appraisal. The appraised value may be exceeded by the amount of up-front guarantee fee financed, if any, when using the non-streamlined option.

(C) A streamlined-assist refinance loan is a special refinance option available to existing Section 502 direct and guaranteed loan borrowers. Applicants must meet the income eligibility requirements of §3555.151(a), and must not have had any defaults during the 12 month period prior to the refinance loan application. There are no debt-to-income calculation requirements, no credit report requirements, no property inspection requirements, and no loan-to-value requirements. There is no appraisal requirement except for Section 502 direct loan borrowers who have received a subsidy.

(ii) The interest rate of the new loan must be fixed and must not exceed the interest rate of the original loan being refinanced.

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(iv) The loan security must include the same property as the original loan and be owned and occupied by the borrowers as their principal residence.

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4. Amend § 3555.108 by revising paragraph (d) to read as follows:

3555.108 Full faith and credit.

* * * * *

(d) *Indemnification.* The loan note guarantee will remain in effect for any holder of the loan who acquired it from an originating lender. If the Agency determines that a lender did not originate a loan in accordance with the requirements in this part, and the Agency pays a claim under the loan guarantee, the Agency may revoke the originating lender's eligibility status in accordance with subpart B of this part and may also require the originating lender:

(1) To indemnify the Agency for the loss, if the default leading to the payment of loss claim occurred within five (5) years of loan closing, when one or more of the following conditions is satisfied:

(i) The originating lender utilized unsupported data or omitted material information when submitting the request for a conditional commitment to the Agency;

(ii) The originating lender failed to properly verify and analyze the applicant's income and employment history in accordance with Agency guidelines;

(iii) The originating lender failed to address property deficiencies identified in the appraisal or inspection report that affect the health and safety of the occupants or the structural integrity of the property;

(iv) The originating lender used an appraiser that was not properly licensed or certified, as appropriate, to make residential real estate appraisal in accordance with § 3555.103(a); or,

(2) To indemnify the Agency for the loss regardless of how long ago the loan closed or the default occurred, if the Agency determines that fraud or misrepresentation was involved with the origination of the loan.

(3) In addition, the Agency may use any other legal remedies it has against the originating lender.

5. Add § 3555.109 to read as follows:

§ 3555.109 Qualified mortgage.

A qualified mortgage is a guaranteed loan meeting the requirements of this part and applicable Agency guidance, as well as the requirements in 12 CFR 1026.43(e)(2)(i) through

(iii) and 12 CFR 1026.43(e)(3). An extension of credit made pursuant to a program administered by a State Housing Finance Agency is exempt from this requirement as defined in 12 CFR 1026.43(a)(3)(iv). Lenders will be allowed to cure unintentional errors and retain the qualified mortgage status if the conditions set in 12 CFR 1026.31(h) are met.

Dated: March 29, 2016.

Tony Hernandez,

Administrator,

Rural Housing Service.

[FR Doc. 2016-10217 Filed: 5/2/2016 8:45 am; Publication Date: 5/3/2016]